

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2009-55-E - ORDER NO. 2009-254

APRIL 9, 2009

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| IN RE: | Petition of Duke Energy Carolinas, LLC |) | ACCOUNTING ORDER |
| | for an Accounting Order to Defer Certain |) | |
| | Environmental Compliance Costs and the |) | |
| | Incremental Costs Incurred from the |) | |
| | Purchase of a Portion of Saluda River's |) | |
| | Ownership in the Catawba Nuclear |) | |
| | Station |) | |
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This matter comes before the Public Service Commission of South Carolina ("Commission") on the application of Duke Energy Carolinas, LLC ("Duke Energy Carolinas" or "Company"), pursuant to S.C. code Ann. § 58-27-1540 (Supp. 2008) and 26 S.C. Code Ann. Reg. 103-825 (1976, as amended), seeking an accounting order for regulatory accounting purposes authorizing the Company to defer in a regulatory asset account certain post-in-service costs that are being or will be incurred in connection with (1) the addition of the Allen Steam Station flue gas desulfurization equipment ("FGD" or "scrubber") related to environmental compliance (scheduled to go into service in the Spring, 2009), and (2) the purchase of a portion of Saluda River Electric Cooperative, Inc.'s, ("Saluda River") ownership interest in the Catawba Nuclear Station (completed in September, 2008). The costs Duke Energy Carolinas is seeking to defer are the incremental costs that are being or will be incurred from the date these assets are placed in service and are used and useful in providing electric service to its South Carolina retail

customers to the date the Company is authorized to begin reflecting in rates the recovery of such costs on an on-going basis. The incremental costs for which this deferral treatment is requested include depreciation, cost of capital, property taxes, and the related non-fuel operation and maintenance expenses.

The Company contemplates filing in July, 2009, an application to increase its electric base rates to reflect among other things the annual costs of these additions. The application will also include a levelized amount to amortize and recover over a period of years the costs deferred and accumulated in the regulatory asset account requested in this petition. The plant cost of these assets is \$680 million (\$170 million on a South Carolina retail basis); the potential adverse impact to the Company's earnings associated with these asset additions (in the absence of the requested deferred accounting treatment) is approximately \$125 million before income taxes (nearly \$31 million on a South Carolina Retail basis) on an annual basis. Notably, the Company's earnings in 2008 were below the authorized equity rate of return allowed by this Commission. Duke Energy Carolinas has represented to the Commission that it will suffer an additional sizeable decline from its allowed equity rate of return in 2009 unless the Company is permitted to defer the costs requested. Avoiding such an adverse earnings impact is important to assure Duke Energy Carolinas can report sustainable financial results necessary to maintain access to needed capital on reasonable terms, particularly during this time of global financial and credit crisis. Duke Energy Carolinas customers are currently benefiting from the increased capacity and reduced fuel costs resulting from an increase in nuclear generation and will soon benefit from the Allen scrubber addition.

The requested relief will not involve a change to any of Duke Energy Carolinas' retail rates or prices at this time, or require any change in any Commission rule, regulation or policy. In addition, the issuance of the requested accounting order will not prejudice the right of any party to address these issues in the subsequent general rate case proceeding. Accordingly, neither notice to the public at-large, nor a hearing is required regarding this petition.

In support of this petition, Duke Energy Carolinas has shown the following facts and has requested the following relief:

Description of the Company

Duke Energy Carolinas is engaged in the generation, transmission, distribution, and sale of electric energy at retail in the central and western portions of North Carolina and the western portion of South Carolina. The Company also sells electricity at wholesale to municipal, cooperative and investor-owned electric utilities and its wholesale sales are subject to the jurisdiction of the Federal Energy Regulatory Commission. Duke Energy Carolinas is a corporation organized and existing under the laws of North Carolina authorized to transact business in the State of South Carolina and is a public utility under the laws of that State. Accordingly, its operations in South Carolina are subject to the jurisdiction of the Public Service Commission of South Carolina pursuant to the provisions of Chapter 27 of Title 58 of the South Carolina Code of Laws.

Addition of the Allen Steam Station Scrubber

Duke Energy Carolinas is committed to installing environmental control technologies to reduce nitrogen oxide (“NO_x”) and sulfur dioxide (“SO₂”) emissions from its coal-fired generating units. The Company’s compliance plans rely heavily on the use of Selective Catalytic Reduction (“SCR”) and Selective Non-Catalytic Reduction (“SNCR”) systems for NO_x reductions and Scrubbers for SO₂ reductions. The Allen scrubber is necessary for compliance with Phase 1 of the Federal Clean Air Interstate Rule (“CAIR”), which begins in 2010 for SO₂ unless and until the Environmental Protection Agency (“EPA”) promulgates a new rule.¹ The installation of the scrubber at the Allen Steam Station is scheduled to be completed by the spring of 2009 at a cost of \$500 million. The cost of the Allen scrubber has been financed wholly by Duke Energy Carolinas’ investors. The Company’s incremental annual cost of depreciation, non-fuel and non-fuel-related operation and maintenance expense, and cost of capital related to placing in service the Allen scrubber approximates \$85 million (\$21 million on a South Carolina Retail basis). The total costs associated with the Allen scrubber to be deferred will be based on the date the scrubber is placed in service through the date the annual cost of owning and operating the Allen scrubber is reflected in base rates.

¹ The EPA finalized its CAIR in May 2005. The CAIR limits total annual and summertime NO_x emissions and annual SO₂ emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO_x and in 2010 for SO₂. Phase 2 begins in 2015 for both NO_x and SO₂. On March 25, 2008, the U.S. Court of Appeals for the District of Columbia (D.C. Circuit) heard oral argument in a case involving multiple challenges to the CAIR. On July 11, 2008, the D.C. Circuit issued its decision in *North Carolina v. EPA* No. 05-1244 vacating the CAIR. The EPA filed a petition for rehearing on September 24, 2008 with the D.C. Circuit asking the court to reconsider various parts of its ruling vacating CAIR. In December of 2008, the D.C. Circuit issued a decision remanding the CAIR to EPA without vacatur. EPA must now conduct a new rulemaking to modify the CAIR in accordance with the court’s July 11, 2008 opinion. This decision means that the CAIR as initially finalized in 2005 remains in effect until the new EPA rule takes effect. The court did not impose a deadline or schedule on EPA.

The Purchase of a Portion of Saluda River's Ownership of the Catawba Nuclear Station

Under an Asset Purchase Agreement between Duke Energy Carolinas and Saluda River, the Company purchased from Saluda River 71.96% of Saluda River's ownership interest in the Catawba Nuclear Station at a cost of \$158 million. The agreement includes the transfer of the appropriate pro rata share of Saluda River's nuclear decommissioning trust fund balance to Duke Energy Carolinas. The Company evaluated the purchase of 71.96% of Saluda River's interest in Catawba Nuclear Station as part of its 2006 Integrated Resource Planning process, and determined that it was a least-cost addition to the Duke Energy Carolinas' generation portfolio under all circumstances. Accordingly, the Commission approved the transfer of the Certificate held by Saluda River for the Catawba Nuclear Station to Duke Energy Carolinas for the portion purchased by the Company in its Order No. 2008-468 in Docket No. 2008-117-E dated July 2, 2008. Taking advantage of this opportunity to purchase base load capacity of a high performance nuclear station greatly benefits Duke Energy Carolinas' current and future customers.

The Company completed the acquisition of this additional ownership interest in the Catawba Nuclear Station on September 30, 2008. The annual cost for depreciation, cost of money, non-fuel operation and maintenance expenses, property taxes and insurance is \$42 million (\$10 million on a South Carolina Retail basis). The costs to be placed into the regulatory asset account will include costs incurred from the September 30, 2008 closing date through the date rates are effective that recover the on-going annual costs of this additional ownership of the Catawba Nuclear Plant. Duke Energy Carolinas'

most recent fuel and fuel-related charge adjustment proceeding incorporated the savings associated with the Company's additional ownership of the Catawba Nuclear Station. The lower fuel costs resulting from the increase in nuclear generation saves South Carolina retail customers \$9 million on an annual basis. The current fuel and fuel-related rates incorporating these savings became effective October 1, 2008, and thus customers are currently enjoying the benefits of this investment.

Financial Consequences of Duke Energy Carolinas' Request

In its most recent earnings surveillance report filed with the Commission, Duke Energy Carolinas reported earnings significantly less than the rate of return on jurisdictional common equity approved by the Commission in its most recent general rate case. The proposed deferral will not result in the Company earning more than its authorized rate of return in 2009. In fact, even if the proposed deferral is assumed, Duke Energy Carolinas projects that in 2009 it will earn below its authorized rate of return. The \$31 million of costs (on an annual basis as allocated to South Carolina) Duke Energy Carolinas seeks to defer is material and equates to more than a 120 basis point reduction in the Company's South Carolina Retail rate of return on common equity that it can earn in 2009. At the same time, because Duke Energy Carolinas will propose in its next rate case to recover the deferred costs over a multi-year period, the ultimate rate impact of this deferral on customers will not be significant.

The Commission is aware of the significant capital expenditures Duke Energy Carolinas must make in the foreseeable future and beyond to comply with environmental requirements, meet customer demand, and modernize its generation fleet and power

delivery system. In the current global financial crisis, the Company's earnings, credit quality, and financial performance are even more closely scrutinized by the financial community generally, and potential investors and credit rating agencies in particular. Many of the fundamental financial ratios reviewed by the various rating agencies in rating the creditworthiness of Duke Energy Carolinas' debt would be adversely impacted by a denial of the requested deferred accounting treatment. In light of the Company's significant capital needs and the global credit crunch, maintaining credit quality is both critical and challenging. The Commission's approval of the requested deferred accounting treatment will enhance the Company's ability to attract necessary capital on a reasonable and timely basis since it re-enforces the market's positive perception of a constructive regulatory environment in South Carolina. Such approval will help mitigate the potential for a significant deterioration in earnings in 2009, which will benefit both the Company and its customers in helping assure investors' confidence in the Company and help assure access to needed capital on reasonable terms.

Effective Date

This order will not preclude the Commission from addressing the reasonableness of the costs deferred in the regulatory asset account in a future general rate proceeding.

Duke Energy Carolinas wishes to reflect the deferral of the requested costs on its quarterly financial reports for the first quarter of 2009. In order to do so, the Company has requested an order approving this deferral as soon as possible, but no later than by the end of the first quarter of 2009.

Conclusion

In summary, authorizing deferral of the incremental annual costs relating to placing in service the Allen scrubber and the Company's additional ownership in the Catawba Nuclear Station are important to the maintenance of its credit quality and financial integrity and will avoid a significant deterioration in its 2009 level of earnings. It is appropriate and reasonable to defer the costs of the Saluda River purchase to avoid loss of recovery of the capital costs incurred by shareholders, particularly given that retail customers are receiving the benefits of the lower fuel and fuel-related costs made possible by the Company's investment in an increased ownership of the Catawba Nuclear Station.

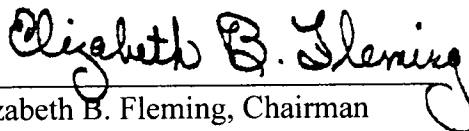
The total investment in the Allen scrubber and the additional ownership of the Catawba Nuclear Station of \$658 million is financially significant and constitutes an extraordinary item of cost. Due to the potential for adverse earnings impacts associated with placing large projects in service, and mindful of the negative financing consequences that can flow from such adverse impacts, this Commission has historically authorized deferred accounting for post-in-service costs of major generating plant additions from the date the units were placed in service to the date rates reflected the cost of the plants. For example, in the Company's 1991 rate case, the Commission authorized the deferral of \$15.607 million of the costs associated with the Bad Creek Pumped Hydroelectric Station during the period between commercial operation of each unit and the date the new rates were approved reflecting the inclusion of the Bad Creek costs. Order No. 91-1022 in Docket No. 91-216-E at p. 31. The Commission has authorized

similar deferral accounting treatment for Duke Energy Carolinas and other utilities for the costs of other generating plants. Thus Commission precedent supports similar treatment for the costs at issue here.

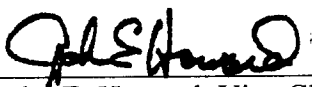
Accordingly, having reviewed the petition of Duke Energy Carolinas and having found the requested deferral in the public interest, the Commission grants the requested relief as set out in this order. The Office of Regulatory Staff has represented that it has no objection to Duke Energy Carolinas' request, and has affirmed that it will monitor the deferral amounts.

This Order shall remain in full force and effect until further order of the Commission.

BY ORDER OF THE COMMISSION:


Elizabeth B. Fleming, Chairman

ATTEST:


John E. Howard, Vice Chairman
(SEAL)